

MAY 7, 1984

THREE DOLLARS

Forbes

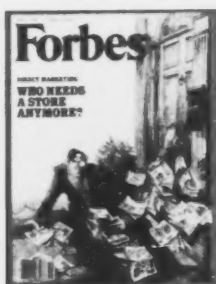
DIRECT MARKETING

**WHO NEEDS
A STORE
ANYMORE?**

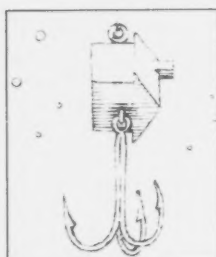


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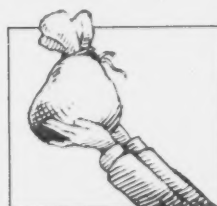
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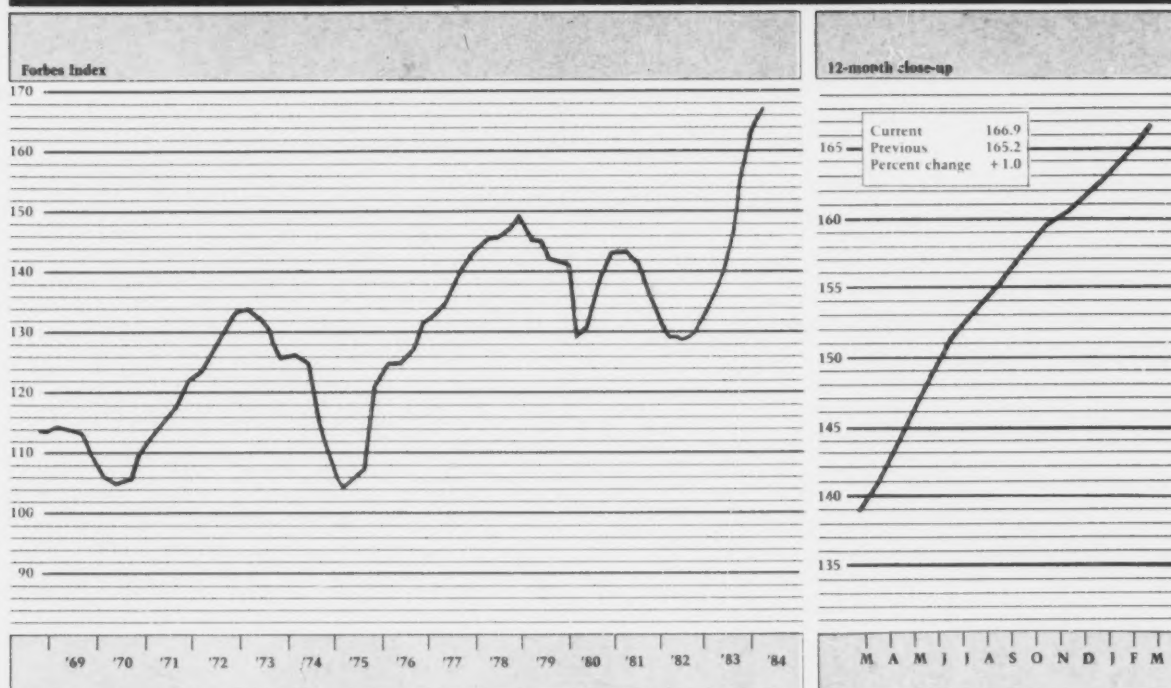
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The Forbes Index



Working its way up. This month's figure for unemployment claims is the only new one in the Forbes Index. This change is enough to push the Index to another record high. From February to March of 1984, initial unemployment claims dropped 3.1%. But that masks the magnitude of the change: The number of newly jobless workers is down

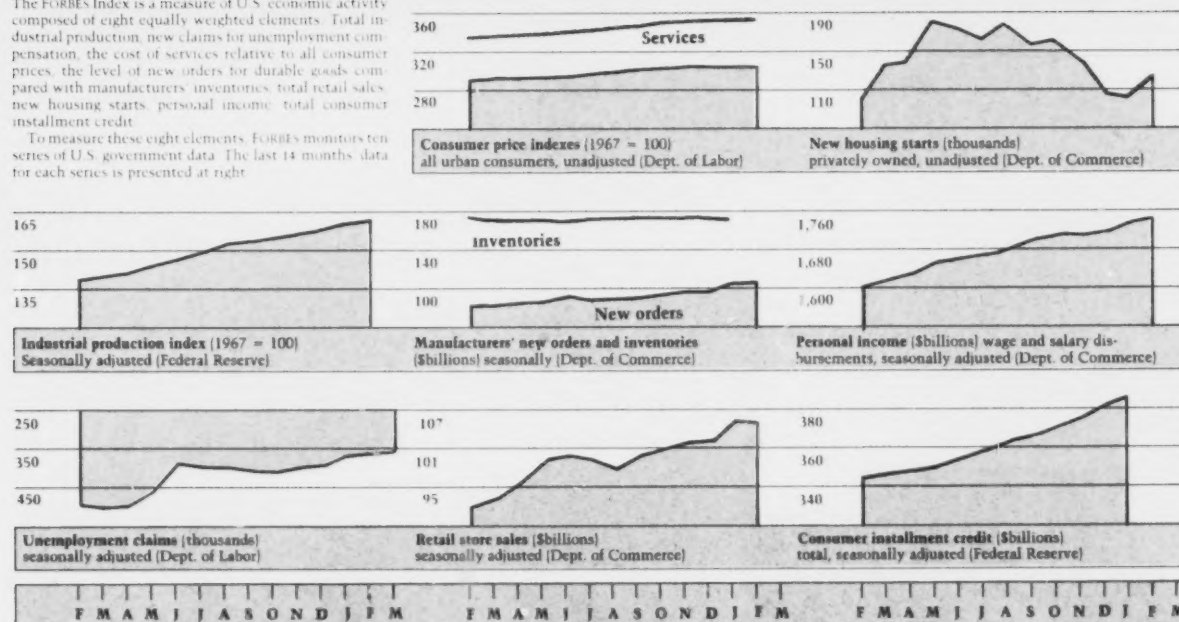
28.1% from March 1983 and 40.4% from March 1982.

A look at weekly figures for this same indicator provides yet another reason to be optimistic about the strength of the recovery. For the week period ending Mar. 31, initial unemployment claims were only 336,000. This is the lowest level since the summer of 1979.

The Forbes Index Components

The FORBES Index is a measure of U.S. economic activity composed of eight equally weighted elements. Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, FORBES monitors ten series of U.S. government data. The last 14 months' data for each series is presented at right.



announced that henceforth it would refuse to purchase a one-year ARM if the first year's rate is more than 2.5% below the base interest rate. Private insurers like Mortgage Guaranty Insurance Corp. and General Electric Mortgage Insurance Corp. started to tighten underwriting standards for ARM mortgages back in February and

March. Nevertheless, the ARMs race goes on. In early April, with fixed rates near 14%, a Long Island savings bank ad read: "new low rate 8.5%, one-year adjustable-rate home mortgages; 11.8% annual rate." In Houston, a home builder offered 7% the first year and "move in for \$1."

What some shortsighted lenders

haven't realized is that there's no free lunch. Sure, you can get business by offering absurdly low first-year rates. But the bill will come due, as it always does. Instead of being able to fob off interest rate risks onto borrowers, these lenders will end up with credit risks that many weak S&Ls and savings banks can ill afford. ■

There's lots of money in the pension fund pot these days. So the bees are buzzing.

Pension funds as profit centers

By Thomas O'Donnell

IN THE LATE 1970s shortfalls in the nation's private pension plans—"unfunded pension liabilities"—approached \$60 billion and amounted to a major worry. No more. Today, about 80% of all plans have surpluses. Instead of a worry, they are a major temptation to cash-hungry corporate treasurers wanting to get at them.

What's wrong with that? After all, they put the money in, why shouldn't they take it out? Well, for one thing, the surpluses in most cases are almost surely temporary. For another thing, they're not unexpected. They constitute what the Employee Retirement Income Security Act (ERISA) calls "experience gains." As attorney Michael Gordon, who helped write the legislation, puts it, "Experience gains

should be retained to offset experience losses." That's why ERISA prohibits sponsors from taking surpluses out of existing plans.

There's a way around it, though: Simply terminate the plan and set up a new one. In fact, 190 plans have been shut down since 1979, netting about \$1.2 billion for their corporate sponsors. Another 52 shutdowns, which will generate an additional \$1 billion, are now awaiting regulatory approval. Lawrence Davanzo, partner with Wilshire Associates, a pension fund consulting firm, estimates that one in ten U.S. corporations is contemplating the termination of its pension plan.

In some cases, it's hard to fault that. "Companies that are in financial difficulty simply cannot afford the luxury of having an overfunded pension plan," says Arthur Williams, manager of Merrill Lynch's \$350 million plan. That's why A&P has been trying since 1981 to end its plan and take out \$200 million, although the action has so far been held up by employee objections and legal action. GAF Corp. raised about \$60 million by ending its plan in 1982. Employees sued, but the courts upheld the company. More recently, Amax Inc., which has lost \$880 million over the past two years, took \$100 million of a \$160 million surplus to pay down debt. "We aren't greedy," says an Amax executive. "We left \$60 million."

Now, though, healthy companies are also doing it. Some are ambitious. Occidental Petroleum, for example, was granted approval from the Pension Benefits Guaranty Corp. and the IRS to use \$360 million in pension overfunding, presumably to help finance its \$4 billion acquisition of Cities Service.

Other companies are worried that pension fund surpluses may turn them into takeover candidates. In 1981 Harper & Row terminated its pension plan and replaced it with an employee stock plan to get its stock in presumably friendly hands. (Not all that friendly, as it turned out: Some employees sued the publisher; the case is still pending.)

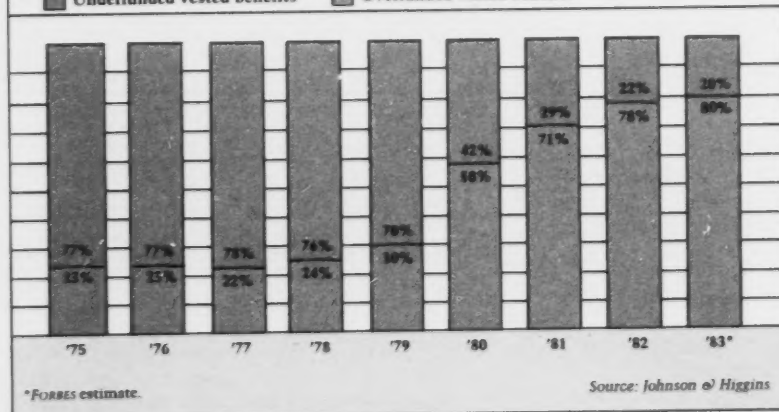
So far, major companies that have

What goes up . . .

Since 1980, large industrial companies with fully funded pension plans have become the majority. Three major factors: higher than expected interest rates, a recession-shrunk work force and a surging stock market.

■ Underfunded vested benefits

■ Overfunded vested benefits



terminated plans have replaced them with something else. To get employees to go along, promised future benefits are sometimes beefed up by as much as 5% or 10%. One alternative is to replace a defined benefit plan with a defined contribution plan, which transfers the risk that inflation will diminish the purchasing power of the pension from employer to employee. "If the market is down when the employee retires, he gets screwed," says one corporate pension plan executive.

Then there is the so-called spinoff being attempted by Amax, among others. This is the newest, fastest growing and most controversial wrinkle. The fund is split in half, and improved benefits are promised to still-working employees to get them to go along. The surplus is then put into the retirees' pot, and annuities are bought to cover them. What's left over goes into the company treasury.

Pension funds got so healthy, of course, because the recession sharply reduced the ranks of those covered, the bull market pushed up stock portfolio values and higher-than-projected interest rates dramatically increased bond yields. But nothing stays the same. The ranks of those covered is rising again as employment rises, and the stock market has been on hold since mid-1983. Only bond yields remain high, because interest rates are staying up.

On the assumption that rates will remain high, some companies are tapping their pension funds indirectly, if not directly—by increasing their estimates of what the companies will earn on their assets. "Some plans have gone from 6% or 7% to 11% or 12%, then 14%," says Roger Thomas, pension counsel to the House Select Committee on Aging. That, of course, allows the company to cut back on its contribution.

Ironically, dipping into the honey pot won't help the stock market, which helped create the present affluence in the first place. "Over the near term the trend toward cutting back on pension fund contributions, whether directly or indirectly, will be bearish," says Prudential-Bache analyst Deborah Bronston. Why? Because in today's institution-dominated market, pension funds are the biggest players. Less money in the pension funds means less money in the stock market.

What it all means is that the pension fund wheel may be about to turn—just when some corporate treasurers are gambling that the good times will go on forever. ■

A major transition is under way in the economy of Taiwan—with important consequences for U.S. business.

The China Reagan can't visit

By Lawrence Minard

FOR REASONS OF STATE it is impossible, of course, but when President Reagan concludes his five-day visit to the People's Republic of China on May 1, he would return home greatly refreshed if he could pause for a few days en route in the China no U.S. President can visit—Taiwan.

Only 110 miles east of the mainland, across the Taiwan Strait but in another world politically and economically, Taiwan would be just the place for a chat between Reagan and leaders of the Third World's struggling economies on how, and how not, to effect economic growth. In Taipei, capital of the Republic of China, as its rulers insist that Taiwan be styled, they would see no waves of bicycles, as in Peking, but swarms of cars and motorcycles; no bored shopkeepers with little to sell, but thousands of well-stocked food shops and bulging department stores; no ideologically pure "revolutionary opera," but throngs of middle-class families flocking to the Tung Wang Restaurant for a fashion show and a concert of very hard rock.

While economies in Latin America, Africa and the Soviet bloc stagnate, Taiwan goes from strength to strength. By dint of hard work, low but rising wages, repressive but stable (and, today, not unpopular) government and an uninhibited business class with access to the rich American market, Taiwan's 19 million people have managed to turn this former Japanese agrarian fiefdom into one of Asia's most dynamic manufacturing economies.

In 1949, when Chiang Kai-shek and

the defeated remnants of his Nationalist Army arrived, the island's per capita income was less than \$50. By 1970 it was around \$350. Today it is \$2,500. That is about double South Korea's income level, light-years ahead of most Southeast Asian countries and a profound insult to the People's Republic of China, whose per capita income is now around \$250. This prosperity is not built on borrowed cash. Taiwan's total foreign debt is only \$8 billion. Foreign exchange reserves: \$14.1 billion.

A little Japan? That greatly understates the case. Adjusted for differences in population, Taiwan's trade surplus against the U.S. last year—a record \$6.7 billion—would be more than double Japan's. This year Taiwan's surplus against the U.S. could hit \$8 billion.

Yet the Taiwanese can ill afford to relax and enjoy the fruits of their hard-earned success. Their economy is at a crossroads. The pools of cheap rural labor have run dry. The days of stable unit-labor costs and huge leaps in labor productivity—increases of over 10% annually from 1952 to 1970—are over. At around \$80 for a 45-hour week, Taiwan labor remains cheap by U.S. and Japanese standards but has become overpriced, compared with the masses in Indonesia, the Philippines, Thailand and on the Chinese mainland. Simply put, Taiwan has no choice but to get beyond its low-wage manufacturing base and develop knowledge- and capital-intensive industries. "The caught-in-between theory that says Taiwan depends on a vanishing supply of cheap labor is simply wrong," says Dr. Sun Chen, vice chairman of the powerful Council for Economic Planning & De-

With the help of computers, show business, shrewd merchandising and your friendly postman, some smart entrepreneurs are restoring shopping to what it used to be—before the advent of rude clerks, jammed parking lots and sales taxes.

A boutique in your living room

By Richard Greene

MARY STAFFORD is a 35-year-old vice president at Fieldcrest Mills. Many a night she curls up in bed with her husband—a senior vice president at Chemical Bank—and relaxes with a pile of mail-order catalogs. The couple has lots of disposable income but not much free time. So they do their shopping, and plenty of it, in bed.

The couple defines upwardly mobile, affluent, educated young professionals. "In three months last year, we both got new jobs, and I had my second child," Stafford says. "So, at Christmas, I shopped for everyone by mail. Now, when I go to bed, I look at every catalog that comes in."

In 1951 Lillian Katz was a 23-year-old New York housewife. Her husband worked hard in his family's lingerie business, and she yearned for an idea that would bring in an extra \$50 a week—the margin between getting by and living nicely. Katz bought a \$495 advertisement in *Seventeen* magazine, offering a monogrammed belt and pocketbook. Orders for \$16,000 worth of merchandise poured in.

Today, Katz owns and runs Lillian Vernon, a direct marketing firm with annual revenues of \$100 million. Her

annual income—after taxes—is well into the millions. She uses a chauffeur-driven Mercedes to travel between her Connecticut lakefront home and a lavish cooperative apartment in one of Manhattan's fanciest enclaves.

Thus have entrepreneurs like Lillian Katz helped turn the needs and wants of people like Mary Stafford into a \$150 billion industry. Participating in the boom, but not always leading it, are some of America's biggest corporations. Last year, for example, American Express sold 2,500 plush fox coats that cost \$1,000 each through the mail. Spiegel, owned by a big German firm, moved about 500 pairs of \$175 Charles Jourdan sandals. And IBM reportedly sold 20% of its typewriter production without salesmen or stores.

Direct marketing, as this business is called, is making sales without the benefit of stores or face-to-face contact with clerks. It now accounts for 14% of all retail transactions. Since catalog orders are growing faster than in-store purchases, that figure should reach 20% before the end of the decade. Business-to-business direct marketing, which covers everything from legal forms to large computers, is expanding even faster.

The big fellows have a piece of this



action, but small entrepreneurs blaze the trail. Maybe that's because there is a lot of show business in direct marketing, and individuals are better at that than big corporations.

Consider Richard Thalheimer, who sells lifestyle as much as he sells a product line. His Sharper Image catalog offers glitzy merchandise that nobody really needs, the consumer society gone berserk. A \$2,395 jet-propelled surfboard is typical. But Thalheimer, who started with nothing in 1977, expects sales of \$100 million this year.

Show business? Meet Harold Schwartz, president of Hanover House, a family of 22 catalogs. He peddles everything from shoes and stainless-steel steamers to decorative lawn birds. Schwartz sports a diamond pinky ring and leaves the top four buttons of his shirt open. Very mod, but also very shrewd. Sales at his company, owned by Horn & Hardart, which trades on the American Stock Exchange, rose 55% last year, to \$220 million. The gimmick? "You can win a 2 carat diamond ring in our \$550,000 anniversary giveaway," trumpets Hanover's Rainbow of Gifts catalog.

Schwartz lays out his progeny like a family genealogy while explaining how each catalog spawned another. "People said, 'You're crazy, Schwartz, you're competing with yourself.' But we're like Procter & Gamble. They've got all kinds of soap."

Why is all this happening? Computer-generated mailing lists help identify prospects, while credit cards and

toll-free long distance numbers facilitate ordering and payment. Customers in such heavily taxed states as New York are well aware that buying by direct mail can be a nearly foolproof way to avoid sales taxes. But there is much more to this boom. Direct marketing is among the most identifiable and easily understood incursions of the service economy into the American way of life.

Retailing, of course, has always been a service business. But direct marketing does what no store can do.

"Hello, this is Betty Bianco. How can I help you?" It is lunch time. A woman from Colorado is telephoning Lillian Vernon to order a lucite towel rack from the spring catalog. The customer knows the item number, price and page number—all the necessary information. Quickly, Vernon's employee, Betty Bianco, puts these and her customer's credit card number on a computerized order form. She says good-bye, with a final pitch about sale-priced goods.

No hassle with parking. No time wasted finding the right size. No lines at the register. Many direct mail orders can be processed as quickly as a conventional retailer can run a credit card check.

How the world has changed. It used to be that the man who sold you your shoes lived down the street. And everyone knew his butcher. But corner groceries yielded to supermarket chains. Department stores replaced specialty shops. Malls supplanted downtown. Now marketing geniuses are folks who study statistics, not

store owners who know that Uncle Harry wants black wing tips like the ones he bought before the war.

"Today," says advertising executive Lester Wunderman, "the computer makes it possible to recreate the same information relationship that used to exist between seller and buyer. A store owner could only remember 3,000 people. A computer can remember 3 million."

Take Spiegel. Over the last eight years, it has changed from a struggling has-been to a successful marketer of high-margin designer fashions and furniture. In 1983, the firm gave a number of top customers a \$35 home entertainment book for Christmas. The gift cost Spiegel only \$10, of course, and tests are under way to see if the promotion sparked enough incremental sales to bear repeating.

Saks Fifth Avenue, by contrast, leads the field in integrating its retail and catalog businesses. If you buy enough children's clothes from a Saks store, for example, within weeks you'll find the Saks kiddy catalog in your mailbox. Service takes another tack at L.L. Bean. There a telephone representative can instantly locate any order—particularly helpful the week before Christmas.

Direct marketing is a major part of what Alvin Toffler calls the "de-massification" of society. Manufacturers can easily satisfy any consumer desire. The trick now is to get all that stuff to all those people, without chaos. And to make everyone feel that, somehow, he is more than just a number.

For sale

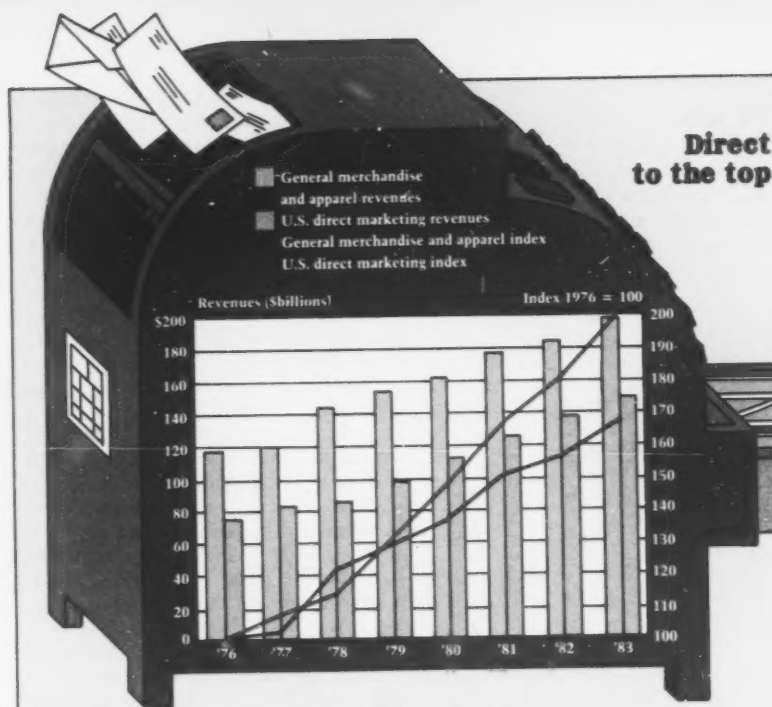
The variety of merchandise available from catalogs is limited only by the fertile imagination of marketers. These 14 items were not selected on the basis of utility (though you may really need a pair of swans) or affordability (the NATO Bomb Suit runs a cool \$12,900). Instead, this array represents the sometimes astonishing extremes of a fast-growing, diverse business.



Capitalist Pig Money Clip
\$60
The Pork Avenue Collection
(617) 523-7447



Mallard Decoy Telephone
\$259
Hammacher Schlemmer
(800) 368-3584



Source: U.S. Department of Commerce; Direct Marketing Association

The dollar volume of direct marketing has not yet caught up with total sales of merchandise and apparel. But direct marketing sales are growing much faster than those of conventional retailers.

Part of the response is the so-called boutique-ing of stores and the proliferation of specialty shops within department stores. But there is no better mass vehicle for one-on-one selling than the catalog.

The L'Eggs division of Hanes Group used to be deluged with letters from nurses asking for fashionable panty-

hose in white—to match their uniforms. No retailer would bother with these specialized items, but nationwide the market was huge. To cash in, L'Eggs now mails catalogs regularly to 250,000 nurses.

Selling people things they couldn't get anywhere else, in fact, is the way direct marketing started. Back in

1886 Richard Sears, a Minnesota railroad agent, bought a shipment of \$25 watches for \$12 each. He sold them to agents along the line for \$14.

Soon Sears was offering a variety of goods, mostly to people who lived half a day away from the nearest big store. Now, of course, it's just the opposite: The shelves are only minutes away. But high labor costs have forced retailers to cut back on help, and parking, traffic and crime are obstacles. So the ordeal of shopping takes half a day.

As a result, direct mail particularly appeals to customers who put a premium on time, like working women. Mail-order marketers know that, and they try to make catalogs just as attractive as stores.

"A catalog cover is no different from a window display," says Jo-Von Tucker, a consultant who has designed over 400 catalogs. "You get a few seconds to convince the shopper to come inside. You use the opening spread to set the mood—just like the department store uses the cosmetics counter."

"There's a real ambience involved," adds Saks' senior vice president for marketing, Paul Leblang. "Number one is the kind of paper we use. Number two is the fact that we shoot on location. We also get a variety of models, and we change their makeup or hairstyles."

Many catalogs also include a letter from either the founder or a buyer for the company. The idea is to create the



Crown Rib Roast of Pork
\$54
Omaha Steaks International
(800) 228-2778



Full-length Mink Coat
\$4,500
American Express Fur Salon
(800) 528-8000



Hero 1 Robot Kit
\$1,199.85
Heathkit
(800) 253-0570

Even giants can play

Don't assume direct marketing is only for mom-and-pop operations. Look at the table below, which shows a dozen of the biggest catalog retailers, and you'll spot a

number of the biggest companies around. The trick for these giants, of course, is to avoid killing off the entrepreneurial spirit in their mail-order acquisitions.

Company/principal merchandise	1983 sales (millions)	% increase from 1982
Sears Merchandise Group /general	\$2,092	11%
JC Penney /general	1,652	7
Mobli Montgomery Ward/general	1,190	4
Otto Versand Spiegel/general	512	30
American Can Fingerhut/general Figi's/food	512	28
New Process /apparel	268	14
Born & Hardart Hanover House/general (22 specialty catalogs)	215	54
LL Bean /apparel and sporting goods	205	7
American Express /high-ticket general	180	20
Quaker Oats Herrschners/crafts Brookstone/tools and household Jos A Bank Clothiers/apparel	152	27
Avon Direct Products /apparel	144	19
RJ Reynolds Jackson & Perkins/nursery Harry & David's/food Bear Creek/toys	111	1

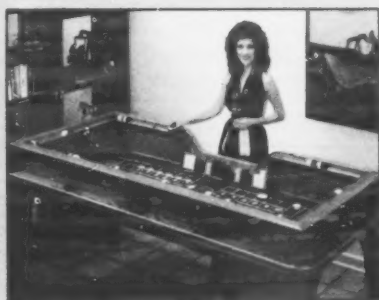
Source: Direct Marketing Association, based on figures provided by companies

impression that there is a human being watching over every item and caring about every customer. Again, image is the name of the game. The avuncular Amos Pettingill at White Flower Farms entertains his catalog customers with clever gardening tips. One hitch. There is no Amos Pettingill. The homey letters come from Eliot Wadsworth, who owns the firm. But who'd trust an Eliot to tell him about dirt?

Aside from creating a bit of personality identification, however, catalog descriptions are secondary. The customer looks at the pictures, and if they grab his attention, he'll look at the price. Then, and only then, will he bother with the text. "I don't sit there and read the history of Lands' End Boomerang Pants," says Adair Faust, a 29-year-old mother from New Orleans who spends about \$500 a year on direct mail purchases. "I just want to know about length and sizes."

Faust, like most steady mail-order shoppers, is deluged with catalogs. A good customer can easily accumulate 200 volumes during the October-to-January mailing season. But even the most successful catalogs draw purchases from fewer than 10% of all recipients, and printing and mailing splashy books can cost up to \$3 each. That's why there is much more to direct marketing than simply waiting for the money to roll in.

The challenge here is called "targeting." Conventional retailers put up a SALE sign and wait for shoppers to beat down the doors. How do direct marketers find customers? One method is



Gaming Table
\$2,500
The Gift Horse
(800) 858-4551



NATO Bomb Suit
\$12,900
Law Enforcement Associates
(201) 751-0001



Miniature Horse
\$1,000 and up
Del Tera Miniature Horse Farm
(803) 472-9788

to place a one-time ad for a representative item. Anyone who buys goes on the mailing list. That explains all those advertisements for seed catalogs in the Sunday newspapers.

Growth, however, comes slowly this way. To get a big list fast, call a list broker. These are middlemen who will arrange for a direct marketer to rent names fitting into a specific category. Advertisements in *Direct Marketing* magazine hint at what's available: "Wig buyers list has 169,000 1981 to 1983 buyers... \$55 per thousand. These are fashion-conscious women mail-order buyers with an average age of 55 who have purchased Eva Gabor wigs from the Wigs by Paula catalog."

You can go even further. Selling sports-car ski racks in Minnesota? Match the list of motorists who own cars that will accommodate ski racks (readily available from the state's department of motor vehicles) with the list of zip codes for relatively affluent areas (from the Census Bureau) with the list of *Ski Magazine* subscribers. All this may cost as much as 15 cents per name, but you buy darn good prospects. The broker will add a few phony entries, to police against more than one use.

The most fortunate direct marketers, of course, already have lists. "Your best customer," as the old pros say "is always your last customer." J.C. Penney, for example, has become the nation's second-largest cataloger merely by tapping its existing customers. Department stores, many of which are making major moves into direct marketing, start with names of

former customers.

American Express plays this game too. It now generates \$180 million in annual revenues from catalogs, bill inserts and solo mailings, sent almost exclusively to credit card customers. Direct marketing revenues have grown 20% annually for the last five years. One reason: Robert Meyers, a former Bloomingdale's executive who came on board in 1976, has moved the product line up-market. Amex now sells jewelry, complex stereo gear, designer watches, \$250 leather shoes and even fur coats.

Meanwhile, Sears, Roebuck, a granddaddy of catalog merchandising, is working to segment its already huge market. This is just a natural extension of targeting—if you can clearly identify your customers' specific needs, why not send them a catalog aimed at those desires? The firm now puts out nearly two dozen specialty catalogs that feature everything from cameras to telephones. One of the newest offerings is pitched to expectant mothers and has articles along with crib and bassinet listings.

For every new Sears catalog, of course, there are dozens of small entrepreneurs who think direct marketing will bring them untold riches. They are seduced by the common illusion that entry costs are low. All you need, so the optimists believe, is a little merchandise and a printing contract, both of which are available on credit. Then open the mail and deposit the checks. Cash flow is immediate. If your catalog is a loser, put out another one. Fast.

Here's the rub. An adequate order-processing system is expensive. Lillian Vernon, for example, has \$5 million worth of computers and employs a 24-hour telephone staff of 150 people. A customer may buy from a persuasive catalog once. But he'll never buy again if the order isn't handled properly. Liberal return policies are also essential for success. Buyers are nervous about not seeing merchandise. Letting them return it without question allays fears.

The need for capital, and the presence of corporate buyers, has led many successful catalogers to sell out. American Can, for example, is assembling a collection of direct mail companies built around giant Fingerhut. Beatrice Foods owns Day-Timers, a prestigious stationery marketer. And Lillian Katz of Lillian Vernon claims to get regular offers, including a recent one from Gillette. Other big outfits, like 3M, are building catalog lines from scratch.

Many large companies, however, have troubles in direct marketing. It's tough to go up against established entrepreneurs who know how to avoid mistakes. Hallmark, for example, admits to losing almost \$3 million on a women's fashion catalog, but some think the figure was far higher. "They had a book with three women's blouses for \$200 each and one for \$50," says a competitor. "The cheaper one sold well while the others didn't, but their next catalog had three blouses for \$200 and one for \$50. All they wanted was to walk around with a gorgeous catalog."



Penguin Thermos
\$45
The Paragon
(401) 596-0134



Norma Kamali Gold Lamé Dress
\$7,000
Spiegel
(800) 345-4500



Red Oak Colonial Pulpit
\$1,590
Ecclesiastical Arts Catalog
(800) 367-8737

What four-letter word?

Don't use that four-letter word starting with *j*," says Postmaster General William Bolger, when you ask him about direct mail marketing. "The boom has been a marvelous thing for the Postal Service."

A marvelous thing, indeed. Thanks in part to the direct mail surge, the Postal Service's income statement has improved dramatically. In 1976 losses reached \$1.2 billion. But last year there was a \$616 million surplus.

Third-class mail, the category that includes most catalogs, now represents 34% of postal volume, up from 27% five years ago. Revenues have increased even faster, to nearly \$4 billion last year. That's still far less than the \$14 billion provided by first class, but third class is growing more than twice as fast as total mail volume.

This has been important in the Postal Service's improved finances. It has huge fixed costs, and growing third-class revenue plays a major role in offsetting them. Third-class mailers, moreover, lighten the post office's labors by presorting and receiving lower delivery priority.

Even as he acknowledges these efficiencies, Bolger wants catalog houses to pay more. He wants a



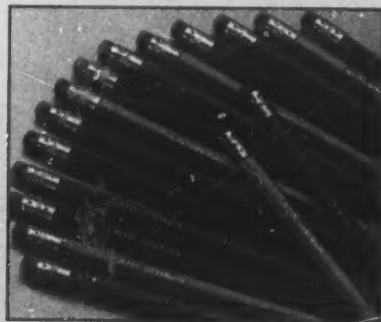
22% increase on third class, vs. 16% on first class. Such are the politics of postal rates. And some folks would like to see even higher fees for packages and advertising mail. Members of the American Newspaper Publishers Association, for example, have lost Sunday supplement business to direct marketers. United Parcel Service, which delivers most mail-order goods, would like to see Uncle Sam charge more, too.—*Laura Saunders*

The risks and pitfalls don't keep catalogs from flooding the mails. There now are 6,500 consumer books, up from 4,500 only a few years ago. But the number of catalogs is growing far faster than the number of catalog shoppers, and this is a danger signal for direct mail's fringe operators.

The recent spectacular expansion has come largely by selling the same 20% or 30% of public more and more products. That's fine, and it has produced enviable growth. But for direct marketing to maintain the pace, the number of people who buy through the mail needs to grow.

When Senator Gary Hart's staff used the mails to raise money, they decided, according to the *Wall Street Journal*, that good prospects could be found on trendy mail-order lists. Not surprisingly, the primaries showed that Hart's appeal was largely to so-called yuppies—young upwardly mobile professionals—many of the same people who shop mail order.

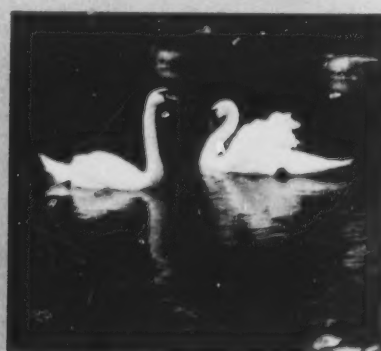
Though Hart may now be faltering, direct marketers seem to have a broader base. Demographic trends mean there will be more working women and retirees, and both groups love catalogs. With the rising cost of keeping a salesman on the road, business-to-business revenues will continue growing, too. Meanwhile, personal computers will enable direct marketers to give better service and target customers ever more closely. As sure as there's a sale every George Washington's birthday, conventional retailers will keep losing business to competitors with no stores. ■



Three Doren Gold-stamped Pencils
\$4.98
Lillian Vernon
(914) 576-6300



Miniature Working Oil Rig
\$3,695
Blue Chip Gifts
(800) 858-4551



Pair of Swans
\$1,200
Sears, Roebuck
(call local numbers)

The real news about insurance brokers isn't their passing imbroglios. It's the challenge to their basic business.

"When is our 1916?"

By Pamela Sherrod

INSURANCE BROKERS CAN'T seem to get out of harm's way.

Early in April Marsh & McLennan, the biggest firm in the industry, revealed that one of its bond traders had gone astray, forcing it to take a \$60 million writeoff. Second-ranked Alexander & Alexander, meanwhile, is still suing a former employee of a British firm it acquired in 1982, after unexpected writeoffs of over \$40 million.

All this is diverting, but it isn't the industry's real problem. Until a few years ago, brokers were the glamour boys of the insurance industry—with faster growth and higher profitability. But their business may never again be as cushy as it once was.

Profits at MarshMac, which grew 16% annually in the Seventies, have stalled at about \$120 million for the past three years. Competitors fared far worse. Earnings are down an average of 53%, from recent peaks at A&A, Frank B. Hall and Corroon & Black. "The peak year for railroads was 1916; since then track miles have been declining," says MarshMac Chairman John Regan. "I think our business is one of the best going, but I do ask, When is our 1916?"

An insurance broker's traditional role has been to act as a middleman between large corporate customers and insurance companies. That can be a comfortable position. No underwriting risk. No need for much capital. The luxury of holding large sums of cash for a few weeks until premiums

are actually paid to insurers.

For their labors, brokers earn a commission of between 5% and 25% of a policy's cost. Conflict of interest? Sure. The more the policy costs, the more the broker makes. But competition among brokers prevents abuse.

What's killing the brokers today, however, is the fact that insurance



John Regan, chairman of Marsh & McLennan
Will fee income help his premium squeeze?

rates are unusually low (see box, p. 120). Since brokers can't rely on investment income, they wind up working twice as hard for half the commissions. "It's fundamentally stupid to have a system where we make a percentage of another guy's price," says Regan.

That's only part of the trouble. In the Seventies, when inflation sent insurance premiums upward, customers began to buy smarter. Brokers used

to be able to buy lunch for their clients and waltz off alone to see underwriters. Now corporate risk managers want to sit in on those negotiations. "Our value-added is being questioned," says Robert Hatcher, chairman of the privately held Johnson & Higgins.

A few companies have managed to do without brokers altogether. By shopping directly, they avoid paying commissions—like consumers who insure with direct writers, such as GEICO or Allstate. Will this catch on for commercial policies? Perhaps. As the trend continues, corporations may develop insurance-buying expertise, much as they are expanding legal departments and setting up in-house travel agencies.

The insurance industry's rate structure is part of the reason for this change. On average, insurers use 30% of premium income to cover operating expenses, including brokers' commissions. But for large policies, insurance company costs are roughly one-third less. "The big purchasers are carrying the weight of the others," explains Bruce Schnitzer, who is head of MarshMac's brokerage business.

Buyers want "unbundled" services to eliminate the subsidy. "The client is more willing to pay for what he really wants but not for what he doesn't," explains John Bogardus, chairman of Alexander & Alexander. If he knows how much of his premium goes for risk underwriting and how much for claims administration and loss prevention, a customer may decide to perform some of those functions internally.

Wonderful for the clients. But not so good for insurance brokers. Now many firms are hustling to offer newly unbundled services. Almost all the major brokers will manage a captive insurance company or handle claims processing. Unfortunately, there is lots of competition in some of these businesses. Georgia-based Crawford & Co. and GAB Business Services, Inc., a subsidiary of UAL Inc., for example, offer national claims-handling service.

How to get paid in this brave new world, when overall premium payments are shrinking? MarshMac's Regan thinks fee income is part of the answer. He wants insurance brokers to work like lawyers or accountants and earn fees accordingly. At the mo-



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Dallas • Houston
Philadelphia • San Antonio
San Francisco (Clift)
Seattle (Olympic)
Washington, DC
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Canada

Montreal • Toronto • Ottawa
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Edmonton • Vancouver

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ment, MarshMac gets up to 40% of its brokerage revenues that way. This helped the firm weather the current downturn better than the competition.

Many conservative brokers, however, cling to old ways, partly out of inertia and partly out of a desire to benefit when rates do finally rise. But a middle ground is increasingly popular: Take commissions for placing insurance and wangle whatever fees you can for other services. "We're in a chaotic state right now," says Hatcher of Johnson & Higgins, which insisted on straight commissions for all insurance purchases until 1980.

Things will get even more confused when banks get into the insurance brokerage business—competition that insurance brokers believe is inevitable. Industry experts figure that the banks will tackle the consumer market first. To get a piece of the \$55 billion in annual commercial premiums, however, it takes expertise. "The only place to get the talent is at the broker firms," says Richard Mil-

Profits are not insured

The fall in premium rates has been bad news for insurance brokers. MarshMac, the most diversified of the lot, got a big boost from its money management operations.

Publicly held insurance brokers	1983 revenues (millions)	% non-insurance	1983 net profit (millions)	% change from 3-yr av ⁴
Marsh & McLennan	\$968	27%	\$123.0	8.3%
Alexander & Alexander	555	14	21.0 ¹	-51.0
Frank B Hall	365	none ²	12.5	-55.0
Corroon & Black	172	none	12.9 ³	-23.0

¹ Before a \$20 million writeoff to bolster insurance reserves. ² Excludes Hall's investment in farmland, a truck leasing company currently in Chapter 11. ³ Before a securities gain of \$5 million. ⁴ 1980-82

ler, president of Corroon & Black.

Miller should know. This spring, Corroon drew an unfriendly takeover bid from Ingram Industries, a privately held conglomerate. Two other big insurance brokers—Fred S. James Co. and Rollins Burdick Hunter Co.—have recently been acquired by insurers. Banks may have to buy their way into the business the same way.

With everything changing around them, insurance brokers need top-flight strategic planning. Without it, the risks in their business today look a lot higher than the rewards. ■

The case of the misbehaving cycle

Property and casualty insurers used to have a predictable six-year rhythm—three years of underwriting profits, then three years of losses. But since 1978 commercial underwriters have been fighting the longest price war in memory.

The current crisis dates from the mid-1970s. When inflation raged, corporate insurance buyers rebelled. They began using more self-insurance, forming captive insurance companies and buying cheaper policies to cover only catastrophic losses. To make matters worse, price-cutting competitors, including foreign insurers and domestic industrial companies, moved into the market.

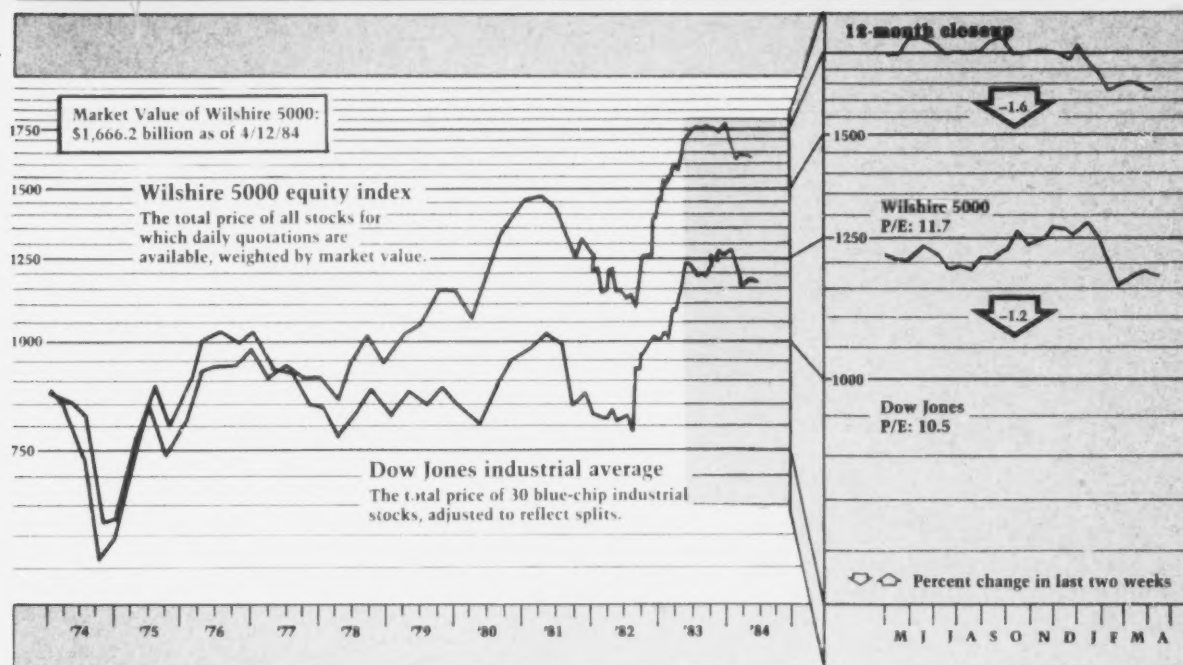
Despite today's grim rate structure, however, most commercial underwriters are still profitable. That's because of high investment income. This worries old-line insurance executives. To them, regular underwriting losses mean business is spinning out of control.

In fact, the margin between investment profits and underwriting losses is already shrinking. Last year underwriting losses increased 28%, while investment income grew only 6%. Some firms are already losing money, and if losses spread, rates will surely rise. "Saying 'there will be no more insurance cycle' is like saying 'the stock market is dead,'" argues MarshMac's Regan.

Whatever happens though, the industry's six-year predictability seems gone forever. Today the growth of captives has peaked, but that's in part because of the low rates they helped create.

Felix Kloman, president of Risk Planning Group, believes that self-insurance may permanently limit the rise of commercial property and casualty rates. If traditional underwriters start boosting premiums, corporations may simply use their homemade alternatives more.—P.S.

The Forbes/Wilshire 5000 Review



Is this any way to get in shape? As the market continues to shed earlier gains, the loss of real and paper profits has put consumers on something of a spending diet. The regimen seems to be working, and market fundamentals are gaining strength. The P/E of the more than 5,000 issues that make up the Wilshire index is now down to 11.7, the lowest figure since January of last year. Despite the rash of cuts in 1984 and 1985 earnings estimates, analysts still predict P/E's of 7.9 and 6.5 for The Forbes 500s index. Unless economic troubles throw these forecasts off, rising profits should put upward pressure on share prices.

Investors, of course, still worry. Concern over budget deficits and heightened inflation helped the Wilshire index lose 1.6% during the last two weeks. NASDAQ stocks were hit harder and suffered a 3.6% decline. Even Amex shares, which were resilient early this year, fell 2.3%. For the four-week stretch, secondary stocks generally lost more ground than widely traded shares. The NYSE was flat for this period, while the Amex fell 2.2% and NASDAQ 3.4%. The investor yardsticks also show that high-volatility and high-growth stocks posted steeper declines than their more conservative counterparts.

Close-up On The Equity Markets

Performance of six leading indexes

Percent change	Wilshire 5000	Forbes 500 ¹	Dow Jones industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
in last 4 weeks	-0.7	0.2	-0.9	0.0	-2.2	-3.4
in last 52 weeks	-2.5	-1.1	-0.7	-0.2	1.9	-13.0

Stock performance based on six key investor yardsticks

Percent change	Company size		Volatility ²		P/E multiple		Dividend yield		Growth profile ³		Share price	
	large	small	high	low	over 25	under 5	over 7.5%	none	high	low	over \$40	under \$4
in last 4 weeks	-0.9	-2.1	-4.8	-0.2	-4.7	-1.4	-1.3	-3.1	-4.4	-1.7	-1.0	-3.9
in last 52 weeks	-0.7	16.9	3.3	10.9	-7.5	12.2	9.3	7.9	6.0	9.0	2.1	9.3

¹Based on sales

²A stock's sensitivity to overall market movement. High volatility issues have wide price fluctuations; low volatility issues are more stable.

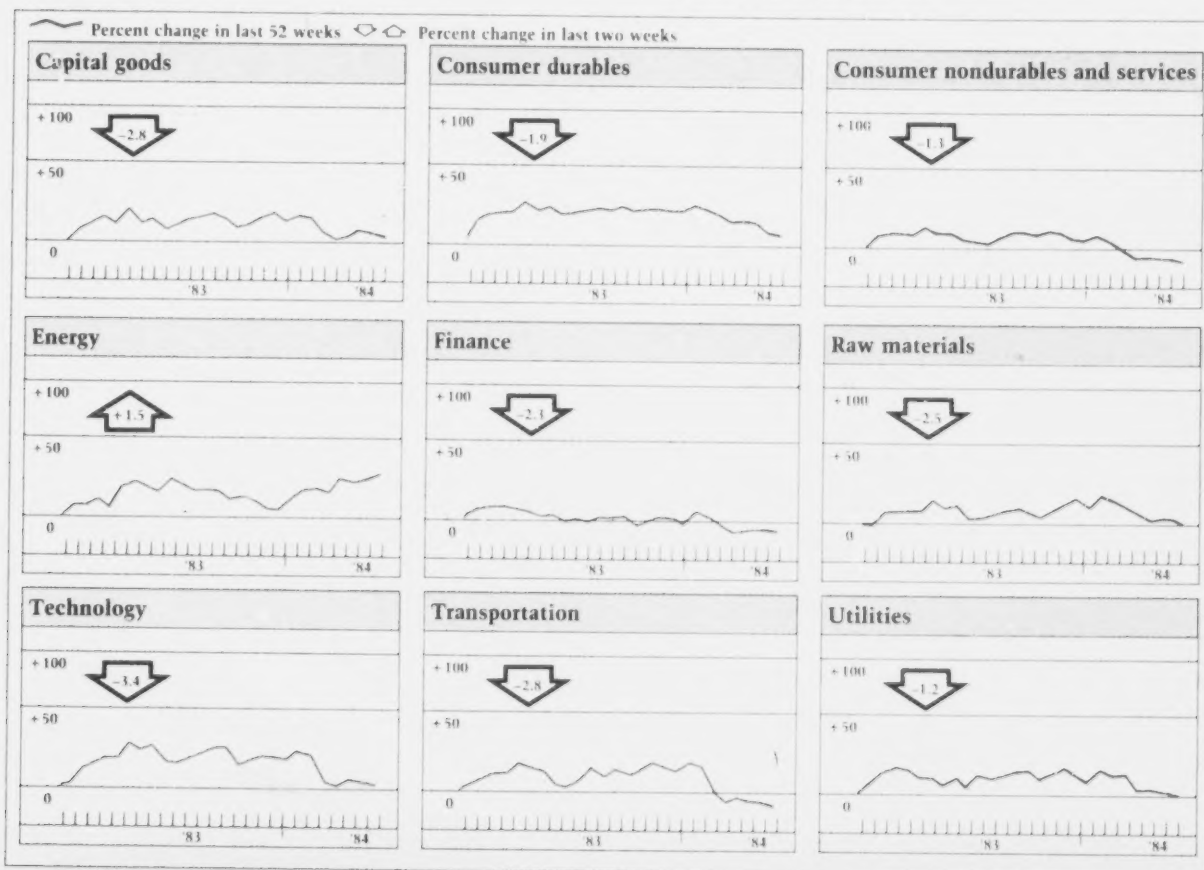
³A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

Note: All data for periods ending 4/12/84. Prepared by Wilshire Associates, Santa Monica, Calif.

Where The Action Is

Finishing behind the start line. Only two groups—consumer durables and energy—are at higher levels now than they were this time last year. Consumer durables are ahead by only 0.9%; and energy stocks, which bounded up from a depressed base, are up 22.5%. Unless there are more major oil takeovers, these shares will have trouble continuing their rapid pace.

During the last two weeks the market's only gain came from energy stocks. Technology companies led the way down with a 3.4% decline. These issues also show the worst 52-week record: They are 9.5% lower today than they were 12 months ago. Capital goods and transportation shares, with losses of 2.8%, are tied for second-poorest two-week performance.



What The Analysts Think

Smiling smokestacks. Analysts often make optimistic earnings estimates and then scale back their projections as the year progresses. Over the last two weeks, however,

the experts raised their 1984 earnings forecasts for consumer durables and capital goods. Meanwhile, energy and transportation stocks show the largest cutbacks.

Forecasting the Forbes 500			Rank based on change in estimate	Sector	Estimated 1984 EPS	% change in 1984 estimate	
Performance period	Average earnings per share	P/E				in 2 weeks	in 4 weeks
latest 12 months	\$2.76	11.5	1	Consumer durables	\$3.51	0.63%	2.31%
1984 estimates	4.24	7.9	2	Capital goods	2.52	0.57	0.72
1985 estimates	5.18	6.5	3	Utilities	3.60	-0.05	-0.04
			4	Consumer nondurables	2.79	-0.60	-0.95
			5	Raw materials	3.43	-0.68	-1.56
			6	Technology	2.18	-0.82	-1.12
			7	Finance	4.01	-0.87	-1.52
			8	Transportation	3.03	-1.55	-3.49
			9	Energy	2.93	-1.57	0.10

Earnings projections are equal weighted consensus estimates from over 1,500 security analysts. Forecasts for the 9 Wilshire sectors are limited to firms with 3 or more estimates with a mean estimate greater than \$0.50. Data are compiled and updated weekly by Zacks Investment Research, a Chicago-based quantitative consulting firm.

Note: All data for periods ending 4/12/84. Prepared by Wilshire Associates, Santa Monica, Calif.; Zacks Investment Research, Inc., Chicago, Ill.